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SE C R E T SECTION 01 OF 02 XXXXXXXXXXXX 000004

NOFORN

SIPDIS

DEPARTMENT FOR EAP/K, EAP/CM, INR

E.O. 12958: DECL: TEN YEARS AFTER KOREAN UNIFICATION
TAGS: CH ECON EFIN EIND EMIN KN KS PGOV PREL
SUBJECT: WAITING AND WATCHING: NORTH KOREA AFTER CURRENCY

REFORM

REF: 09 XXXXXXXXXXXX 167

Classified By: Consul General Stephen B. Wickman. For
Reasons 1.4 (b) and (d)

¶1. (S/NF) SUMMARY: On December 15, EAP DAS XXXXXXXXXXXX and XXXXXXXXXXXX staff met with XXXXXXXXXXXX, a major player here in Chinese-North Korean economic exchanges. XXXXXXXXXXXX attributed the DPRK's recent currency reform to several factors: controlling rampant inflation, preventing 'hot money' flows, leveling the wealth gap between workers and traders, controlling domestic currency, and most importantly, uncovering potential political opposition. As a result of the reform, commerce has come to a halt. The leadership, as part of an ambitious 2012 development strategy, hopes for the restoration of relations with the United States. XXXXXXXXXXXX also believes that current plans assume Kim Jong-il will be around for some time and that Kim Jong-un will be his successor. The recent recall of DPRK scholars, students and scientists from China following the defection of a North Korean exchange student, for example, suggests increasing levels of paranoia.
END SUMMARY.

GIVE ME GOOD REASON

¶2. (S/NF) On December 15, EAP DAS David Shear and Consulate Shenyang staff met with XXXXXXXXXXXX, XXXXXXXXXXXX visits Pyongyang frequently. Admitting he is unsure of the exact value of Chinese investment into North Korea, XXXXXXXXXXXX believes the number to be many billions of renminbi. Chinese companies, like their ROK counterparts, use North Korea as a processing zone, primarily in the mining and seafood industries. According to XXXXXXXXXXXX, the DPRK leadership's 2012 target for achieving 'strong-country' status should form the principal basis for analyzing recent political developments, including the currency reform measure.

¶3. (S/NF) The most important reason for the recent DPRK currency reform, according to XXXXXXXXXXXX, is to uncover political opposition, particularly against Kim Jong-il's younger son. Controlling inflation, leveling the wealth gap, controlling domestic currency and access to foreign currency, are all part of this strategy. XXXXXXXXXXXX believes that the third son, Kim Jong-un, favored the currency revaluation, and that going forward Kim Jong-un leans toward a Vietnamese-style of economic reform. Opposition to the currency exchange, according to XXXXXXXXXXXX, might reveal who opposes the ascension of Kim Jong-un to leadership. According to XXXXXXXXXXXX, Kim Jong-il's support of the currency reform points to his favoring the third son; those opposing the revaluation, also oppose the third son. XXXXXXXXXXXX drew parallels to the 2009 nuclear tests, which he said were also influenced by succession plans. XXXXXXXXXXXX said that the first son, Kim Jong-nam, opposes his younger brother's reform plans and favors a Chinese-style of economic opening.

¶4. (S/NF) XXXXXXXXXXXX said that the number of factions competing for Kim Jong-il's attention have made it increasingly difficult for Kim Jong-il to listen to anyone. As a sign of Kim Jong-il's paranoia, he recently recalled all students, scholars, and scientists in China following the defection of an exchange student in Northeast China. He did this despite the need for Chinese knowledge, production skills, and technology to achieve the country's goals for 2012. However, XXXXXXXXXXXX believes that current instability will settle and the government will move ahead with reform, fully expecting Kim Jong-il to be around for sometime to come. The reform, according to XXXXXXXXXXXX, may not be toward a more open economy. Rather, with currency reform giving the regime the ability to control domestic currency, reforms will lead to tighter control over the economy.

¶5. (S) Prior to revaluation, one dollar equaled 3500 won. To put that in perspective, the average worker in Pyongyang earns 3000-4000 won per month. XXXXXXXXXXXX reported that according to the DPRK Embassy, the official exchange rate following reform

is now one dollar equals 129 won. For the common person,

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besides suffering from a significant cut in won-based savings, supermarkets and department stores that deal in won have suspended activity as they wait to see what impact currency reform will have on commodity prices. Thus, it has become difficult to purchase day-to-day needs. XXXXXXXXXXXX pointed out, if commodity prices rise, the economy will be ruined. However, if prices settle as a result of reform, and assuming constant wages, the economy will be okay as workers once earning one dollar a month will now earn nearly 20 dollars.

¶6. (S) Traders, who earn many times more than the average wage-earner, have been unaffected by the reform in monetary terms, as savings are held mostly in euro and dollars. Since the revaluation, only stores dealing with foreign exchange have been open and prices in these stores have increased 400-500 percent. For example, a TV that cost RMB 4000 now costs RMB 20,000. Many of these stores raised prices in anticipation of the reform, with the expectation that prices would then fall. However, prices have not fallen. Many of the stores that raised prices prior to reform have since been closed by the government, their goods confiscated. Thus, even traders who have not lost money from revaluation now have nothing to buy. Chinese traders along the North Korean border have also been affected by currency reform even though most trade is done in euros and dollars. As is the case within North Korea, people are waiting and watching to see what will happen to prices. In the meantime, nobody wants to sell anything.

NOT A CRISIS YET BUT CLOSE

¶7. (S/NF) XXXXXXXXXXXX does not believe the DPRK is in crisis mode at this time. As he said, the people are used to this sort of thing. He saw the currency reform as being part of a broader conflict within the government as it moves forward in the next several years. Since 2002, the DPRK has allowed some economic reform, without expressing strong support or opposition. As he put it, the government has been waiting and watching to see what would happen.

CHINA, the U.S., and EVERYTHING

¶8. (S/NF) XXXXXXXXXXXX said many in the DPRK believe the Chinese do not understand their country. While neither the Chinese nor the DPRK are likely to criticize the other in public, XXXXXXXXXXXX said that in private the DPRK has disparaged the Chinese for not including North Korea on its list of 147 tourist destinations or 137 investment destinations. These omissions and the disparate Chinese actions on regional development projects clearly indicate that North Korea is not a priority for the Chinese. For instance, while China recently elevated the long-beleaguered Changchun-Jilin-Tumen River development plan to a national level project, the DPRK left the Tumen River Development Plan, as it sees no benefit (REFTEL). Relations between the two countries were getting so bad, in fact, Premier Wen Jiabao visited Pyongyang two months ahead of schedule.

¶9. (S/NF) According to XXXXXXXXXXXX, North Korea has set an ambitious target of developing a strong country by 2012. As part of this project, it is planning to build 100,000 residential apartments in Pyongyang by 2012. In order to encourage Chinese investment, the DPRK is offering Chinese investors mining and ocean rights for their injection of cash into the project. A former Consul General of the North Korean consulate in Shenyang, recently spent two weeks in Beijing attracting about RMB 12 billion for this project and planned to come to Shenyang following his time in Beijing.

¶10. (S) Restoration of relations with the United States is another important part of the DPRK's reform plans. He said, however, that North Korea looks forward to an ongoing cycle of ups and downs in negotiations and that it counts on the U.N. to be slow in implementing sanctions. As he said, he believes that once things settle down, North Korea will show China and the U.S. "its bottom card."

WICKMAN